CCGG Canadian Coalition for Good Governance

THE VOICE OF THE INVESTOR

Executive and Director Compensation Guidebook

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Executive Summary

Compensation is perhaps the most effective tool available to a board of directors to retain, reward and incentivize senior management to create shareholder value. Therefore, it is not surprising that substantial time is spent by boards of directors on both designing and implementing compensation plans and by shareholders on understanding management compensation plans. CCGG believes that it is difficult to espouse compensation best practices which may be consistently applied across industries and companies. The board of every public company is responsible for, and accordingly must be actively involved in, establishing, and independently verifying compensation philosophy, selecting performance measures, setting performance targets, and assessing performance against these targets. Boards of directors and compensation committees are also in a better position, relative to external parties, to design compensation plans which would best retain, reward, and incentivize management teams. Having said that, we believe boards of directors should give due consideration to the perspective of the company's shareholders when designing compensation plans. In this guidebook, we share an institutional investors' perspective on some of the most important compensation topics that are relevant to the Canadian market, including but not limited to the following:

Executive compensation structure

We believe that a significant portion of executive pay should be at-risk and tied to performance. Furthermore, we encourage boards to: (a) use stock options with caution and with appropriate safeguards (see page 7), (b) not guarantee vesting under performance share unit plans, (c) avoid excessive perquisites, benefits, and severance packages, and (d) restrict special compensation awards to exceptional, well-justified, and clearly articulated circumstances.

We also offer guidance on how to structure special compensation when it is used (see page 10).

Performance metrics and targets

Compensation should be linked to metrics that are within management control and which drive long-term, sustainable, shareholder value creation. We encourage boards to: (a) disclose performance metrics, targets, and outcomes clearly, (b) accompany non-GAAP performance measures, if used, with plain language commentary explaining the appropriateness of material adjustments made to GAAP figures, (c) set sufficiently challenging performance targets under variable compensation plans (see page 13), and (d) refrain from using an excessive number of performance metrics in the executive compensation scheme so that senior management remains focussed on the most important business value drivers (see page 13).

Risk mitigation

We continue to encourage boards to implement policies that minimize compensation-related risks, including but not limited to: (a) anti-hedging and anti-monetization policies, (b) broad clawback policies (see page 15), and (c) share ownership polices which encourage executive leadership to build a meaningful common share interest over their tenures (see page 15).

Target compensation

We encourage boards of directors (and compensation committees) to give considerable thought to and take an active role in selecting the organizations that comprise the defined peer groups which are used for sourcing executive talent and setting target compensation. Care should be taken to avoid the unjustified inclusion of peer companies from industries or from countries where compensation levels tend to be higher (see page 19).

We also suggest that the quantum of compensation offered to executive officers be determined within the context of the organization as a whole and be justified primarily by company-specific factors such as size, complexity, and, most importantly, a company's and an officer's past performance (see page 19).

Non-executive director compensation

We encourage non-executive board members to take at least 50% of their total director compensation in the form of common shares or full value, share-based awards such as DSUs.

Previous CCGG guidance on compensation-related topics

CCGG originally published its Executive Compensation Principles in 2009 to provide enhanced guidance to boards and to promote compensation decisions that are aligned with long-term company and shareholder success. CCGG further refined and updated our Executive Compensation Principles document in 2013.

Many of the principles covered in the 2013 Executive Compensation Principles document remain relevant and broadly applicable and are incorporated within this document. This latest guidebook on executive and director compensation has been expanded to cover new topics that continue to be addressed during CCGG's board engagement program through which we annually engage with approximately 30 leading Canadian public companies on matters within a board of directors' purview. This guidebook also consolidates recommendations set out in other standalone compensation-related publications that have been issued by us following the release of our 2013 Executive Compensation Principles document, including publications on the following topics: (a) Performance share units, (b) Director compensation, (b) Use of non-GAAP performance measures in executive compensation, and (d) Effective management share ownership policies.

Best practices for proxy circular disclosure

CCGG annually publishes a 'best practices for proxy circular disclosure' document. We encourage boards of directors and compensation committees to review this document for further guidance on how to improve the quality of their annual disclosure dealing with executive and director compensation matters.

1. Executive compensation structure

Executive compensation is typically granted in the form of a fixed base salary, a variable cash bonus, and long-term, equity-linked, or share-based instruments such as stock options, performance stock units (PSUs) and restricted stock units (RSUs). In addition to these awards which are often referred to as direct compensation, officers often receive indirect compensation in the form of perquisites and pension benefits, among other elements of compensation.

a. Mix among various compensation elements

CCGG believes that a significant component of executive officer direct compensation should be at-risk and dependent on performance. We consider the following widely used components of direct compensation to be at-risk and dependent on performance:

- Cash bonus, excluding any guaranteed portion.
- Performance-based full-value equity, excluding any portion that is guaranteed[1] to vest. PSUs whose vesting is fully contingent on future performance are the most common type of performance-based full-value equity awards.
- Stock options, when used appropriately[2].

Of note, equity-linked awards such as RSUs, restricted shares, and guaranteed portions of PSU awards that vest solely on the basis of time are not considered at-risk, performance-based compensation, although the ultimate realized value of these awards varies to some extent based on share price. Similarly, any portion of cash bonus that is guaranteed to pay out over time is not considered at-risk compensation by investors.

When determining the proportion of total direct compensation that should be granted in the form of at-risk awards (i.e. cash bonus, PSUs, and stock options) we suggest that compensation committees take the following factors into consideration:

- **OFFICER TENURE:** all else equal[3], officers who have served in the same senior management role for a longer time may be issued a greater proportion of direct compensation in the form of at-risk compensation awards relative to those who have been newly promoted or appointed[4].
- **OFFICER SENIORITY AND ROLE:** the proportion of direct compensation issued in the form of at-risk compensation awards, particularly in the form of share-based awards, may increase with officer seniority and may be higher for roles where there is greater officer ability to influence corporate and share price performance.
- **OFFICER TOTAL COMPENSATION:** the proportion of total compensation granted in the form of at-risk compensation awards may increase with increases in total compensation. That is, after a competitive base salary has been offered to an executive officer, further increases in compensation may be granted in the form of at-risk awards.

When determining the mix of various elements of at-risk compensation, we suggest that compensation committees take the following factors into consideration:

- **INDUSTRY DYNAMICS:** in certain industries where share prices are highly dependant on commodity prices and vary significantly based on changes in business cycles, or where share prices depend to a great extent on factors beyond management control, performance-based awards that, on a relative basis, are less dependent on the organization's absolute share price performance such as cash bonus awards and performance share units may make up a greater proportion of at-risk compensation.

1 Refer to the discussion on guaranteed vesting below on page 8.

2 Relative to other instruments, stock options are a riskier form of compensation and should be used with caution (see discussion on page 7 for tips on how to reduce risk associated with stock option use).

3 Recommendations set out in this document should not be considered in isolation.

4 We recognize that, to recruit or retain talent for certain roles, particularly to fill officer positions that are a layer or two removed from the chief executive officer role, newly appointed employees may need to be offered a higher proportion of total compensation in base salary as opposed to at-risk compensation awards.

- **COMMON SHARE INTEREST:** officers such as business founders who hold a very large common share interest in the company relative to their net worth may be issued a greater proportion of at-risk compensation in the form of cash bonus awards.

b. Stock options – tips on reducing risk

CCGG prefers (as opposed to strongly recommends) the inclusion of performance-conditioned full-value awards such as PSUs within compensation structures over stock options[5]. Shareholders generally are discouraging the use of stock options as a significant component of executive compensation, arguing that options may encourage inappropriate risk-taking and may lead to unintended reward outcomes that are not well aligned with long-term performance. Another criticism levied at stock options is that payouts are extremely volatile and options, relative to other instruments that are widely used in compensation schemes, provide the greatest leverage to share price movements. Share price movements may often be due to a change in industry or sector-wide market sentiment as opposed to company-specific factors within management control.

Where a board believes using stock options is in the best interests of the company, CCGG recommends that compensation committees consider implementing one or more of the following to reduce risks associated with using stock options:

- **PROPORTION AND TERM OF STOCK OPTIONS:** Reduce the weight assigned to stock options in favour of performance-linked, full value awards, such as PSUs. We often hear that stock options, with a long term such as seven to ten years, are better at incentivizing long-term value creation relative to PSUs which vest and settle over a three-year time horizon. We believe that PSUs which settle in shares that must be held for a period of time after vesting, say five to seven years, would result in better alignment of management interests with shareholders. In our view, common shares issued under a PSU plan with long-term (five to seven year) restrictions[6] on their sale would substantially encourage the same long-term behavior that a long-term option award would.
- **CAP ON NUMBER OF OPTIONS:** Limit the number of stock options granted during depressions in commodity or business cycles to avoid the risk of unduly excessive compensation being granted to management based on factors beyond their control.
- **SET HIGH OPTION STRIKE PRICE:** Use a higher strike price than existing market price when market price of a company's common shares is depressed. This reduces the risk of rewarding management for normal course oscillations in a company's share price. Utilizing such "high watermark" features within stock option plans is recommended in cases where options are used in industries where share prices are highly volatile. Utilizing a high watermark feature would reduce the risk of rewarding an officer multiple times for normal course oscillations in share price.
- **PERFORMANCE VESTING CONDITIONS:** Consider introducing performance-vesting provisions to stock options. Performance-vesting provisions are a means of mitigating the risk of rewarding executives for share price movements clearly driven by factors beyond management's control. For example, stock options that vest based on relative total shareholder return (measured against relevant industry or sector-specific constituents) are less likely to be influenced by factors beyond management control.

Use of options and other similar instruments (e.g. share appreciation rights) is more problematic when a company operates in an industry in which share prices are frequently and significantly impacted by factors beyond management's control (e.g., commodity prices). When options are used in such industries within compensation structures, we

5 We believe that, within the TSX Composite Index, stock option use has declined over time for two key reasons: (a) boards of directors have started to limit stock option issuance to the most senior officers of a company as opposed to issuing options widely across all roles throughout the organization, and (b) boards have been reducing the proportion of stock options within senior officer direct compensation packages.

6 Note that common shares that have already vested but which are still subject to holding restrictions do not need to be held by an officer following their departure from the company unless the officer needs to hold onto these shares in order to satisfy the organization's post-retirement share ownership requirements.

encourage boards to highlight reasons[7] (see footnote) for utilizing stock options within proxy circular disclosure, as well as describe steps taken by the board to ensure stock option payouts are not driven by factors beyond management control.

CCGG acknowledges that, for certain issuers, there may be valid reasons for using stock options within management compensation programs in a meaningful manner including for instance in cases where an issuer has limited cash reserves and wishes to utilize compensation instruments that are both long-term in nature and which do not burn the company's existing cash reserves.

c. Guaranteed vesting under performance-based equity awards

In the interest of improving the alignment between pay and performance, many public company boards across all sectors in Canada have introduced performance stock unit (PSU) plans into their executive compensation programs over the past decade or so. A PSU, in short, is a "phantom" award that tracks the value and total return on a common share over a defined period of time. The awards granted under a PSU plan typically vest at the end of a three-year performance period and the number of units which actually vest is tied to some element of corporate performance (often total shareholder return relative to a peer group of companies). In some cases, PSU plans are being used in place of stock option plans which have not achieved the originally intended outcome of linking pay with performance. CCGG is supportive of improving this link and believes that an appropriately structured PSU plan may be helpful in that regard.

Given the PSU name and specific link to a performance metric or group of metrics, most investors would assume that the range of possible vesting outcomes for PSUs would potentially include 0% pay out. While most PSU plans do contemplate 0% vesting scenarios (a common range is between 0% and 200% of target), plans used by a small number of issuers incorporate a "floor" or minimum guaranteed level of vesting, regardless of performance. While boards in these instances often state that they retain the right to exercise discretion to reduce the award value to zero, such discretion exists for virtually all forms of compensation and is rarely used. CCGG believes that the use of the term performance share unit in these instances is potentially misleading to investors, given that a portion of the award will vest under any circumstance irrespective of performance. That portion is tantamount to granting the executive additional RSUs (which typically vest over time and have no link to performance). CCGG believes it is appropriate for boards to revisit how they characterize the guaranteed portion of PSU awards in proxy circular disclosure and potentially designate this guaranteed portion as being a RSU, so that investors do not erroneously assume that vesting of these awards is contingent upon performance conditions being met.

In some cases where a floor vesting level is used within PSU plans, boards have identified specific minimum performance conditions which, if not met, would lead to a zero-vesting outcome. Failing that, a minimum guaranteed vesting level would apply. In these cases, CCGG believes it is important for boards to ensure that the threshold performance conditions that would lead to a zero vesting outcome are critically assessed and have an appropriate level of probability attached to them. Boards electing to take this approach should comment on the credibility of the threshold performance conditions described in the company's proxy circular.

7 One valid reason often cited by boards of relatively smaller cap issuers operating in the oil & gas exploration & production industry (an industry greatly impacted by commodity prices) for using options is that exploration success as well as production growth, as opposed to macroeconomic factors such as commodity prices, have greater influence over the issuer's stock price over the term of the option contract.

d. Indirect compensation – perks, benefits, pension, and severance

In addition to direct compensation (salary, cash bonus, stock options, and share-based awards), a company may need to offer other, non-direct, forms of compensation such as pensions, benefits, perquisites, and severance packages to attract and retain talent. When such indirect compensation is offered, boards should ensure that it is not excessive relative to standard market practices.

When setting executive officer indirect compensation, we encourage boards of directors and/or compensation committees to take the following into consideration:

- **PENSIONS:** Under defined benefit pension plans, caps, or limits on total pension payable, often expressed as a dollar amount or as a percentage of base salary, may be considered. Furthermore, extra years of pensionable service and other special terms not commonly offered within the Canadian market such as a higher-than-standard pension accrual rate should be avoided.
- **BENEFITS:** Benefits that are non-standard within the market in which the company operates should also be avoided. Certain benefits and perquisites such as tax-gross ups and personal use of corporate aircrafts are particularly controversial within the Canadian market and should not be used absent truly extraordinary circumstances such as when legacy benefit entitlements of executive officers need to be maintained in order to close a business acquisition.
- **SEVERANCE:** Non-standard severance packages should be avoided as well. Some examples of non-standard severance entitlements occasionally used in the Canadian market include:

  - Severance that exceeds two times base salary and cash bonus. In addition to evaluating the multiple of base salary and cash bonus that is offered, boards of directors should also consider the dollar value of severance that is offered. The dollar value of a severance package which is equal to two times base salary and cash bonus may be excessive in cases where base salary or cash bonus is set at a substantially higher-than-normal level relative to peer organizations.
  - Providing severance as well as accelerating vesting of unvested compensation awards following a change of control only, absent any termination without cause (sometimes referred to as a 'single trigger' employment clause).

When non-standard compensation needs to be offered under special circumstances these circumstances should be clearly described in proxy circular disclosure.

e. Special, one-off, and other related compensation awards

Investors carefully assess special, out-of-plan, compensation awards that are granted in addition to normal course compensation. We encourage boards of directors to only utilize such compensation under special circumstances and to clearly describe circumstances that warranted the board to issue out-of-plan awards. Regular use of special compensation may lead shareholders to question the quality of internal succession plans or the usefulness of existing compensation plans.

In addition to encouraging clear disclosure[8] on special compensation that has been granted to executive officers of the company, we suggest that boards of directors take the following guidance into account when utilizing special compensation awards:

- Absent extraordinary circumstances (such as when a company needs to grant special compensation to replace awards that were forfeited by an employee in order to join the company), special compensation should be based on (or backed by) the company's and/or an individual's performance.
- Avoid issuing special compensation awards when management outperformance could be attributed to luck as opposed to skill. For example, special compensation should be avoided during an industry-wide cyclical downturn.
- Consider using vesting conditions that exceed those offered under normal course compensation awards (to encourage longer-term thinking). For example, if in the normal course, share-based awards vest and settle between one to three years after grant date, share-based awards that cliff vest (i.e. vest 100%) after three years should be considered for special compensation awards.
- Consider using performance targets that exceed those used in the normal course (to avoid paying managers more than once for achieving the same performance levels). For example, if a 5% annual growth rate for earnings per share has been set under the company's normal course compensation plans a higher growth rate for earnings per share should be considered under special compensation awards.
- On vesting, in order to encourage longer-term thinking and better alignment with shareholder interests, a meaningful portion of special compensation should be settled in common shares or DSUs that must be held until retirement.

8 Clear disclosure would include details on the target value (and vesting range) of compensation granted in the form of special awards, the nature of awards granted (e.g. PSUs, RSUs, options, or cash) and performance conditions, if any, that need to be satisfied for the awards to vest.

2. Performance metrics and targets

CCGG does not typically recommend specific performance metrics for inclusion within a company's compensation plan. We do, however, encourage boards to link compensation outcomes to performance measures that are within management's control or influence, and which incentivize long-term, sustainable, shareholder value creation. Performance measures utilized in the executive compensation scheme should be easy to understand for executive officers, should be aligned with corporate strategy and should drive culture and behaviours that the company wishes to attain.

No compensation metric or measure is perfect; therefore, we expect boards to regularly review the most significant performance measures driving compensation outcomes and consider whether these measures are driving the right behaviors.

a. Disclosure of performance metrics, targets, and payouts

Most shareholders expect issuers to disclose performance metrics that are used to determine the value of variable compensation (cash bonus and performance share unit awards). Furthermore, most constituents of the TSX Composite Index now disclose performance targets that were set for financial and other key operating performance metrics that are used in the compensation scheme as well as discuss how the company performed relative to targets that were set for the most recently completed fiscal year. Therefore, where relevant, we encourage boards of directors to clearly disclose performance measures that are used to determine variable compensation along with targets that were set for the most recently completed fiscal year as well as discuss how the company performed relative to these targets.

Disclosure describing compensation decisions, including the disclosure of performance metrics and targets, becomes even more important in circumstances where there isn't an obvious link between variable compensation and the company's share price performance over a long period of time.

b. Non-GAAP financial measures

When non-GAAP financial measures drive a significant portion of incentive compensation and when financial measures used in the compensation scheme have been subject to extensive adjustment, it is important for boards to clearly articulate their rationale for approving all material adjustments that have been made to GAAP figures.

While the use of non-GAAP performance measures in compensation schemes is not inherently inappropriate, their presence and the apparent reliance placed on them by boards necessitates additional disclosure in order for investors to fully understand the executive compensation decision making process.

Today, the most material gaps between existing proxy circular disclosure and shareholder disclosure expectations include the following:

- An explanation of parameters used by the board to determine the appropriateness of individual adjustments which the board may make from time to time to GAAP figures that are used in the compensation scheme, and
- A plain language discussion on the board's rationale for approving any material adjustments to GAAP figures that were used in the compensation scheme during the most recently completed fiscal year.

Readers are advised to refer to CCGG's 'best practices for proxy circular disclosure' publication to review examples of Canadian companies that are providing the above disclosure to shareholders.

c. Setting appropriate performance targets

In order to incentivize long-term value creation, CCGG advocates for the inclusion of long-term, multi-year performance targets within compensation schemes. For example, under PSU plans a single three-year relative total shareholder return (TSR) target covering the entire three-year time horizon is preferred by investors over three annual one-year TSR targets covering the same three-year time horizon.

As discussed above and where relevant, any performance measure used in the executive compensation scheme should be accompanied by relevant (and, when possible, objective) performance targets that were set for the most recently concluded fiscal year as well as a discussion on how the company performed relative to these targets. Furthermore, where relevant, performance targets should be sufficiently challenging to achieve and, when possible, performance targets should provide executive management sufficient incentive to aim for continuous improvement as opposed to maintaining the status quo. Shareholders review the following information and other relevant data in order to gauge whether a performance target utilized within the compensation scheme is appropriate and/or sufficiently challenging to achieve:

- Historical results delivered by the company as well as those delivered by relevant industry peers,
- Forward looking targets, if any, communicated by the company and relevant industry peers, and
- Forward looking targets prepared by external industry experts.

We encourage boards of directors to review the above information and other relevant data when setting performance targets for measures that are used within the compensation scheme.

d. Adding a new performance measure to the compensation scheme

As noted above, we encourage boards to link compensation outcomes to performance measures that are within management control or influence, and which incentivize long-term sustainable shareholder value creation. We advise boards of directors to refrain from incorporating too many performance measures within the executive compensation scheme as doing so may distract senior management from focussing on the most important business value drivers.

When deciding whether to add a new performance measure to the compensation scheme of executive officers, boards of directors should consider:

- **MATERIALITY:** that is, whether the new performance measure is relevant to the organization's business strategy and material to sustainable shareholder value creation.
- **DUPLICATIVE EFFECTS:** that is, would the new performance measure, over a reasonable time horizon, also result in an improvement in other performance metrics that are already used in the compensation scheme.
- **EXECUTIVE ACCOUNTABILITY:** that is, is the new performance measure more appropriate to utilize below the executive level i.e. within the compensation scheme of an officer or an employee who has greater influence over or responsibility for the measure.

3. Executive compensation risk mitigation

a. Anti-hedging and anti-monetization policies

Directors, officers, and employees of a public company should not be permitted to reduce their economic interest in the company by entering into financial contracts of any kind. All derivative instruments as well as any other financial instrument that may be used to reduce an individual's downside risk to a company's securities should be prohibited under the organization's anti-hedging policy, insider trading provisions or other corporate policies.

Transactions that monetize an individual's economic interest should also be prohibited absent truly extraordinary circumstances such as extreme financial hardship. Where an insider has monetized or hedged their economic interest this should be clearly disclosed in proxy circular disclosure along with the board's rationale for approving such activity.

b. Clawback policies

CCGG advocates for the adoption of broad clawback policies that may be triggered by either a financial restatement or employee misconduct[9] as opposed to narrow clawback policies which are only triggered if an employee intentionally engages in behaviour that leads to a financial restatement.

We believe that all forms of incentive compensation (including cash bonus, RSUs, PSUs, and stock options) should be covered under a clawback policy.

Should the policy be triggered by a financial restatement, boards of directors should be able to clawback all relevant portions of incentive compensation which were granted based on financial statements that were subsequently restated. Should the policy be triggered by misconduct we believe the clawback policy should provide boards of directors with sufficient flexibility to consider what timeline may be appropriate for exercising the clawback (typically a very large portion of incentive compensation is settled within three years of grant date unless stock options with an expiry date that significantly exceeds three years are used extensively).

Clawback policies should cover all members of the executive team, and all officers who are eligible to receive RSU, PSU and stock options awards.

c. Share ownership policies and practices

Executive officers, particularly the CEO and other members of the C-suite, should hold a meaningful common share interest in the companies they manage. We believe that boards of directors should encourage greater common share ownership amongst the most senior officers of the company. The following recommendations provide boards with a range of alternatives which would support this objective and strengthen management alignment with shareholder interests.

1. Establish share ownership requirements that continually build an officer's economic interest over time.

    a. One such approach would be to shift from an ownership requirement with a defined threshold to an annual share purchase requirement. For example, requiring CEOs and NEOs to annually invest a minimum of 20% and 15% respectively of their realized total direct compensation (TDC) in common shares is a reasonable share purchase expectation. This requirement would lead to share ownership levels that approximate 1.0 times and 0.75 times TDC for CEOs and NEOs respectively 5 years after appointment and 2.0 times and 1.5 times TDC for CEOs and NEOs respectively 10 years after appointment to their role.

    b. Another avenue would be to require NEOs to either: (a) use a portion of the cash proceeds received upon vesting of any cash-settled share-based awards to purchase common shares of the company, or (b) retain a portion of shares they receive upon settlement of any share-based awards. While such requirements are not

9 A misconduct clause under a clawback policy may be triggered by any activities that are illegal, activities that result in a breach of fiduciary duty, intentional violation of or disregard for company policies and codes of conduct, or any activity that would result in an employee being dismissed for cause, etc.

prevalent in Canada, we note that some public issuers in the United States require CEOs and other NEOs to retain at least 50% of net after-tax shares received from settlement of equity-based compensation awards until retirement.

2. Establish and express share ownership requirements relative to TDC, rather than base salary.

    a. In many cases, base salary is the smallest component of TDC and, on average, represents only 21% of TDC for all Index issuers. Consequently, the vast majority of share ownership policies have threshold requirements tied to base salary that ultimately equate to less than 1.0x TDC. If the purpose of the threshold requirement is to define an ownership stake that is meaningful in the context of the NEO's own economic circumstances, then we believe the relationship between the threshold requirement and TDC is important to highlight and disclose.

3. Require CEOs and other officers to meet a majority of their ownership requirements through common shares alone.

    a. While they serve other purposes, equity-linked instruments (such as RSUs and PSUs) are generally not regarded by institutional investors as being equivalent in nature to common share holdings. We believe it is reasonable to expect 75% or more of share ownership requirements to be met through common shares alone. Ideally, 100% of share ownership requirements should be met through common shares after a reasonable time has passed and most share-based awards and options granted during an officer's anticipated tenure at the company have vested and paid out.

4. If credit is to be given for compensation awards within share ownership policies, such credit should be limited to awards that have vested, are full value in nature, and which must be held until retirement. For example, deferred share units (DSUs) are full value awards that often need to be held until retirement and, therefore, credit may be given under share ownership policies for vested DSUs.

    a. Stock options, which are not full value awards and therefore, do not track total shareholder return, whether vested or unvested should not be included in an officer's share ownership test.

    b. Credit should not be given for unvested RSUs or PSUs within share ownership policies until such awards vest. Upon vesting, credit should be given for awards that are either: (a) settled in shares which must be held, or (b) in cash that must be invested to purchase common shares of the company on the open market.

5. Share ownership policies that determine the value of securities held by officers at the higher of market value or acquisition price do not align well with shareholder interests. This accommodation gives officers the benefit of a floor value, in the event that share prices fall, while at the same time giving officers the opportunity to enjoy any upside when share prices increase following an officer's purchase of common shares. We believe a more appropriate policy would consistently value securities at either market value (our preference) or at acquisition price.

We also believe that post-retirement shareholding requirements are a useful tool that boards of directors can use to support succession planning within key roles of the organization.

d. Long term vesting of share-based compensation

To the extent that issuers use options and other share-based incentives that vest based on time only, CCGG encourages boards to utilize long-term vesting restrictions (so that longer-term thinking is promoted and management interests are better aligned with shareholder interests over a longer time horizon).

RSUs often start vesting one year after award date and fully vest after three years. CCGG encourages issuers to utilize RSUs that cliff vest, that is, for an award with a three-year term, 100% of the award vests three years after being issued as opposed to 1/3rd of the award vesting per year over the same three years.

Similarly, stock options that cliff vest after a three-year time period are preferred over those that vest equally on the first three anniversaries of grant date, assuming a consistent option term/expiry of five years.

e. Equity compensation plan cost – shareholder dilution

Securities-based compensation plans[10] are an important tool which, when properly used, effectively link management interests with those of shareholders.

Shareholders carefully review the number of shares (and percentage of total shares[11]) that have been reserved under securities-based compensation plans to assess the overall cost of such plans. We encourage boards of directors and compensation committees to take the following factors into consideration when utilizing securities-based compensation plans:

- **TYPE OF AWARDS USED:** A share reserved under a full-value award that vests on the basis of time only, such as an RSU award, is more likely to vest and should have a higher cost associated with it relative to stock options, which only have value and settle in shares if share price exceeds the strike price.
- **HISTORICAL VESTING RANGE:** PSUs most commonly vest between 0% and 200% of the number of units granted meaning that the number of shares actually issued under PSU plans can vary quite considerably. When determining the potential cost of PSU plans, we encourage boards of directors to use a realistic estimate for the number of shares that may be issued under PSU plans. In cases where PSUs, over a reasonable time frame of say five to ten years, have consistently vested above target (above 100%) we suggest that boards take this higher payout into account when determining the cost (dilutive effects) of PSU plans.
- **LIMITS AND CAPS:** We encourage boards to pay attention to and limit the number of time-based awards (RSUs, options and guaranteed PSUs) they issue during depressions in commodity or business cycles to avoid the risk of unduly excessive compensation being granted to management based on factors beyond their control. Similarly, limits on the proportion of all securities-based compensation awards that may be granted to one insider during a calendar year should also be considered absent extraordinary circumstances (e.g. when a one-time award needs to be made to recruit a new CEO).
- **MARKET CAPITALIZATION:** Issuers with a larger market capitalization should utilize a lower percentage of shares under securities-based compensation plans given that even a small percentage of outstanding shares represents a significant dollar value.
- **ROLLING AND RELOADING PLANS:** Shareholders prefer securities-based compensation plans with a fixed number of shares reserved under them as opposed to plans that are reloading and which reserve for issuance a rolling maximum percentage of outstanding shares.

10 Note that securities-based plans include compensation plans under which shares are reserved to be issued from treasury. Compensation plans under which awards are settled in cash or by using shares acquired on the open market are not dilutive to shareholders although they do have a cost associated with them.

11 A large number of companies that make up the TSX Composite Index now disclose burn rate, dilution rate, as well as overhang rate associated with securities-based compensation plans. We, therefore, encourage all issuers to consider disclosing this information when they utilize securities-based compensation plans.

4. Target and realized value of total compensation

Shareholders carefully assess total target as well as realized compensation and any material changes made to target total compensation levels of senior executives over time.

We encourage boards of directors and compensation committees to take the following into account when setting and making changes to target compensation levels for the CEO and his or her direct reports:

a. External equity and benchmarking

CCGG supports the retention of key talent and understands that compensation needs to be competitive with the market for executive talent. However, in determining the overall quantum of compensation to award, we caution compensation committees from placing too much emphasis on the relative positioning of total compensation against a list of industry peers. While external considerations are important, overreliance on these factors can lead to ever-increasing compensation levels unrelated to performance, particularly where total compensation is specifically targeted at percentile ranges above the median of the peer group.

We believe that considerable thought should be given to selecting organizations that make up the market for executive talent. We recommend that compensation committees keep the following in mind when picking organizations that make up the peer group that is utilized to assess the quantum of compensation:

- **SIZE:** Peer companies should be of a comparable size to the organization, ideally, no larger than two times the company's own market capitalization or enterprise value. We advise boards to not use total revenue to shortlist companies for inclusion in the peer group especially when picking peers from an industry that is very different from that served by the organization.
- **INDUSTRY:** Peer companies should ideally be selected from industries that are most likely to recruit from the same talent pool.
- **COUNTRY:** Peer companies should ideally be selected from countries where a majority of the company's operations are located and from regions where the company primarily recruits executive talent. However, Canadian companies with operations in the United States should not limit peer group selection exclusively to the Canadian and U.S. market. For a more balanced perspective, we recommend that boards of directors consider reviewing compensation offered to executive officers in developed markets other than the United States, for example United Kingdom.
- **OUTLIERS ("CHERRY PICKING"):** Peers or peer companies that are outliers in terms of quantum of compensation offered to executive teams should be avoided. Executive pay should not be benchmarked against compensation that is offered to "once in a generation" business leaders. Similarly, "cherry picking" companies from industries (e.g. precious metals) or from countries (e.g. United States) where compensation levels tend to be higher should be avoided. Boards of directors should, independently of the company's compensation consultant, be able to defend the inclusion of peers that appear to be outliers relative to the company in terms of size, scope of operations, and other key criteria commonly used to select peer companies.

b. Company-specific factors (including company performance)

Absent extenuating circumstances, quantum of compensation granted should be determined within the context of the organization as a whole and should be justified primarily by company-specific factors such as size, complexity, and, most importantly, a company's and an officer's past performance. Boards of directors or experts retained by them, at times, inappropriately target officer compensation at median levels set within the industry, using the argument that realized compensation would be below median levels should the company's (or officer's) performance fall below expectations. We believe that there is no justification in setting target compensation at median levels within the industry for a CEO or other executive officer who consistently performs below market expectations or for an officer who has not proven their abilities in a reasonably equivalent role within a similar industry. We strongly encourage boards to base officer target compensation levels on performance and an officer's demonstrable skills and to avoid benchmarking compensation to industry median levels in all cases.

Shareholders carefully review and assess the quantum of compensation offered to the chief executive officer role relative to that offered to other important roles within the organization. Significant and unusual[12] (see footnote) gaps in compensation offered to the CEO role and that offered to other senior executive positions may lead to a discussion with a board of directors on the quality of internal candidates available for the CEO position.

c. Realized compensation and board use of discretion

Shareholders carefully evaluate the realized value of compensation and are particularly concerned when substantial compensation is realized during periods when corporate performance has not met expectations. Board use of discretion is encouraged by shareholders when compensation outcomes are out of sync relative to shareholder experience over a reasonable time horizon. We encourage boards to be aware that extraordinary events unrelated to the performance of executives can lead to unintended pay outcomes and, should this be a recurring occurrence, we encourage boards to modify compensation schemes such that in the future the occurrence of such unintended pay outcomes may be minimized.

The board should maintain the ability to use informed judgment to alter payouts under incentive compensation plans in unusual or unanticipated situations. If such discretion is used, the board should fully disclose in the company's proxy circular the fact that it has exercised discretion to modify pay outcomes along with reasons why this was considered appropriate. We believe that discretion should be applied rarely and, when discretion is used, it should be applied equally in both directions to increase or decrease payouts.

12 Given that named executive officer compensation offered at companies that make up the Composite Index is publicly disclosed, this compensation data is subject to close review and scrutiny. It is, therefore, rare for a named executive officer of a Composite Index issuer to receive compensation that does not fall within a competitive range relative to the market for talent. A discussion with boards is therefore warranted in circumstances where gaps between a CEO's compensation and that offered to other named executive officers is unusual for a given industry or for similar organizations.

5. Non-executive director compensation

a. Quantum

CCGG believes that director compensation should be sufficient to adequately compensate directors for their expertise and experience, nature of responsibilities and the time devoted to the company. While director compensation must be sufficient and designed in a manner to attract excellent candidates it should not be so high such that it risks compromising the independence of directors, their ability to take a controversial stand on an important issue, or their preparedness to resign on a matter of principle.

We encourage boards of directors to take the following into consideration when setting the quantum of director compensation:

- **COMPANY SIZE, INDUSTRY AND COMPLEXITY:** The quantum of director compensation should vary, depending on company-specific factors such as size, industry, and complexity as well as the need to recruit directors from various geographic regions.
- **DIRECTOR RESPONSIBILITIES:** There should be no distinction in pay for directors performing similar roles – for example, all else equal, directors based in the United States should not be compensated at higher levels relative to directors who are based in Canada. Differentiation of compensation levels among directors based on relative time commitment and responsibilities, however, may be appropriate. For example, being an independent chair, or a lead director typically entails a greater time commitment with more responsibilities and accordingly may warrant additional compensation for such roles. In addition, particularly time-consuming committees may justify higher compensation as well as additional retainers for the chairs of these committees. Participation in ad hoc committees could also warrant additional compensation for a director.

b. Structure and share ownership

Determining the components (or structure) of director compensation is just as important in ensuring that compensation does not compromise the independence of directors or encourages them to take inappropriate risks. We encourage boards of directors to take the following into consideration when structuring their own compensation and share ownership requirements:

- **PERFORMANCE-BASED AWARDS:** In instances where there is an equity-based component of compensation, the amount should not be determined based on corporate performance, because doing so may encourage inappropriate risk-taking or promote a short-term perspective over the long-term interests of the corporation.
- **STOCK OPTIONS:** Options are not appropriate instruments for directors of public companies as they can create incentives that are not aligned with the interests of shareholders.
- **DEFERRED SHARE UNITS AND RESTRICTED STOCK UNITS:** Director compensation plans can facilitate the achievement of minimum director shareholder requirements and encourage directors to continue to invest in the company beyond the minimum level. Full value equity awards with the same economic interest as shares (for example, deferred share units or restricted share units) are appropriate forms of equity-based compensation for directors in lieu of cash as they directly align the interests of directors with those of shareholders. We suggest that at least 50% of total director compensation be granted in the form of common shares or full value, share-based awards such as DSUs.
- **VESTING OF DIRECTOR SHARE-BASED COMPENSATION:** Equity-based remuneration for directors should not be subject to vesting periods or performance conditions (discussed above). If issuers use RSUs with time vesting conditions for directors, we recommend that RSU plans include provisions that accelerate vesting of such RSUs should a director choose to resign from the board on a matter of principle.
- **PENSIONS, BENEFITS AND PERQUISITES:** While directors may be reimbursed for reasonable out-of-pocket expenses (such as travel and educational costs), we do not think it is appropriate for independent directors to receive other benefits and perquisites that are typically offered to senior executives of the company such as pensions, severance packages, health care benefits, vehicles, and club memberships.

- **DIRECTOR SHARE OWNERSHIP:** Directors should be subject to a share ownership requirement which is meaningful relative to total director compensation. Only common shares and deferred share units should count towards a director's share ownership. RSUs may temporarily be included in a director's share ownership as long as these awards are settled in shares which must be held by directors or in cash which must be invested to purchase common shares. We encourage every non-executive director to hold some common shares throughout their tenure on the board and to not solely rely on share-based instruments to satisfy director share ownership requirements.